Low Income Housing

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Low Income Housing

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Low Income Housing

- **Background:**
- Tax Reform Act of 1986: Rental Housing Tax Credits (RHTCs) were created under Section 42 of the Internal Revenue Code.
- RHTCs are a financial incentive for developers to construct or rehabilitate housing developments for rental to low-income persons.
- RHTCs are federal tax credits which are allocated to for-profit and not-for-profit developers of affordable rental housing.

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- In Indiana, the organization that administers the competitive process by which tax credits are awarded is the Indiana Housing & Community Development Authority (HCDA).
- HCDA also is responsible for monitoring tax credit properties to insure that they comply with the federal law.
- By reducing a developer's federal tax liability, or selling of tax credits to investors, tax credits can contribute significantly to the financial viability of developing affordable rental units.

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- Units receiving RHTCs must be rented to persons at or below 60% of the area median income. Each state has a limit on the amount of tax credits that it can allocate and demand runs about four times higher than available resources.

- RHTC properties can be either new construction or rehabilitation of an existing building(s). They can also contain a mix of units, some that are rented at rates affordable to low-income persons and others that are rented at market rates.

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- Developers have a choice as to what percentage of units they rent to different income levels. For example, they can choose to rent at least 20% of their RHTC units to households that earn at or below 50% of the area's median income or they can chose to rent at least 40% of their tax credit units to households that earn at or below 60% of the area's median income.

- All RHTC income and rent limits are based on the area's median income. This data is published annually by the U.S. Department of Housing and Urban Development (HUD). These limits vary by metropolitan area or county within the state and by number of people in the household.

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- Most developers also set aside a percentage of units that can be rented to lower income persons, including those who earn no more than 30, 40, or 50% of the area's median income.
- In most cases, the maximum rent that a resident can be charged (including utilities except telephone and cable television) is calculated as 30% of the maximum income limit for the household size. The household size is based on the number of bedrooms in the unit, not the actual number of persons residing in the unit. A calculation of 1.5 times the number of bedrooms in the unit determines the household size.

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- There are several requirements that developers must abide by in renting RHTC units. The two most important requirements are: 1) they must offer the RHTC units at affordable rates; and 2) they must rent RHTC units to persons who earn no more than specified incomes. Applicants are subject to standard rental screening procedures as well as income qualification.
- If the entire household is comprised of full-time students, they may not qualify for a RHTC unit. Also, developers cannot discriminate against persons who receive Section 8 vouchers or certificates.

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- The period of time a developer receives credits is typically ten (10) years. The tax credits are sold to investors who receive a reduction on their federal tax return. Also, there is typically at least a fifteen (15) year restriction, and more likely a thirty (30) year deed restriction limiting the use of the property to low-income housing.

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- IC 6-1.1-4-39 (***Emphasis Added***)
  Assessment of rental property and mobile homes; low income rental housing exclusion
  Sec. 39. (a) For assessment dates after February 28, 2005, except as provided in subsections (c) and (e), the true tax value of real property regularly used to rent or otherwise furnish residential accommodations for periods of thirty (30) days or more and that has more than four (4) rental units is the lowest valuation determined by applying each of the following appraisal approaches:

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- (1) Cost approach that includes an estimated reproduction or replacement cost of buildings and land improvements as of the date of valuation together with estimates of the losses in value that have taken place due to wear and tear, design and plan, or neighborhood influences.
  (2) Sales comparison approach, using data for generally comparable property.
  (3) Income capitalization approach, using an applicable capitalization method and appropriate capitalization rates that are developed and used in computations that lead to an indication of value commensurate with the risks for the subject property use.

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- (b) The gross rent multiplier method is the preferred method of valuing:
  (1) real property that has at least one (1) and not more than four (4) rental units; and
  (2) mobile homes assessed under IC 6-1.1-7.
  (c) A township assessor (if any) or the county assessor is not required to appraise real property referred to in subsection (a) using the three (3) appraisal approaches listed in subsection (a) if the assessor and the taxpayer agree before notice of the assessment is given to the taxpayer under section 22 of this chapter to the determination of the true tax value of the property by the assessor using one (1) of those appraisal approaches.

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- (d) To carry out this section, the department of local government finance may adopt rules for assessors to use in gathering and processing information for the application of the income capitalization method and the gross rent multiplier method. A taxpayer must verify under penalties for perjury any information provided to the township or county assessor for use in the application of either method.

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- (e) ***The true tax value of low income rental property (as defined in section 41 of this chapter) is not determined under subsection (a). The assessment method prescribed in section 41 of this chapter is the exclusive method for assessment of that property. This subsection does not impede any rights to appeal an assessment.***
  As added by P.L.1-2004, SEC.8 and P.L.23-2004, SEC.9. Amended by P.L.199-2005, SEC.3; P.L.146-2008, SEC.85.

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- IC 6-1.1-4-40 (***Emphasis Added***)
  Exclusion of federal income tax credits in the determination of the assessed value of low income housing tax credit property
  Sec. 40. ***The value of federal income tax credits awarded under Section 42 of the Internal Revenue Code may not be considered in determining the assessed value of low income housing tax credit property.***
  As added by P.L.81-2004, SEC.58.

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- IC 6-1.1-4-41 (***Emphasis Added***)
  Assessment of low income rental housing
  Sec. 41. (a) For purposes of this section:
  (1) "low income rental property" means real property used to provide low income housing eligible for federal income tax credits awarded under Section 42 of the Internal Revenue Code; and
  (2) "rental period" means the period during which low income rental property is eligible for federal income tax credits awarded under Section 42 of the Internal Revenue Code.

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- (b) ***For assessment dates after February 28, 2006, the true tax value of low income rental property is the greater of the true tax value:***
  (1) determined using the income capitalization approach; or
  (2) that results in a gross annual tax liability equal to five percent (5%) of the total gross rent received from the rental of all units in the property for the most recent taxpayer fiscal year that ends before the assessment date.
  (c) The department of local government finance may adopt rules under IC 4-22-2 to implement this section.
  As added by P.L.199-2005, SEC.4. Amended by P.L.1-2006, SEC.132.

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- IC 6-1.1-10-16.7
  Real property
  Sec. 16.7. All or part of real property is exempt from property taxation if:
  (1) the improvements on the real property were constructed, rehabilitated, or acquired for the purpose of providing housing to income eligible persons under the federal low income housing tax credit program under 26 U.S.C. 42;
  (2) the real property is subject to an extended use agreement under 26 U.S.C. 42 as administered by the Indiana housing and community development authority; and

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- (3) the owner of the property has entered into an agreement to make payments in lieu of taxes under IC 36-1-8-14.2, IC 36-2-6-22, or IC 36-3-2-11. *As added by P.L.19-2000, SEC.1. Amended by P.L.185-2001, SEC.1 and P.L.291-2001, SEC.195; P.L.186-2001, SEC.2; P.L.1-2002, SEC.18; P.L.179-2002, SEC.3; P.L.1-2006, SEC.133 and P.L.181-2006, SEC.42.*
- ***Note: "The legislative intent is to use the "PILOT" to establish a fund to encourage rehabilitation of affordable housing and to establish programs with resources for affordable housing clientele at the state and local level."*** (Lincoln Village Cooperative, Inc. v. Bartholomew Co. PTABOA, IBTR–5/30/2008)

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- **<u>Pedcor Investments-1990-XIII, L.P. v. STB (9/2/1999):</u>**

- A 13-acre, 160-unit apartment complex in Franklin. Pedcor entered into an agreement with the City of Franklin, under which Pedcor would build an apartment complex that would serve low and moderate income tenants in Franklin. The agreement called for a number of land use restrictions and covenants, the most significant of which is that 40% of the rental units in the apartment complex were to be rented to low and moderate income tenants.

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- Pedcor appealed its 1992 and 1993 assessments, alleging that the apartment complex suffered from obsolescence due to the requirement that 44% of the rental units be leased to lower-income tenants and the effect that requirement had on the marketability of the remaining rental units. Pedcor contended that the State Board failed to consider evidence that the deed restrictions on the property and the decreased market acceptability of the apartment community as a whole were causes of economic obsolescence.

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- In Pedcor's view, the deed restrictions caused the apartment complex economic obsolescence because 44% of the rental units were to be rented at 13% to 20% less than the market rate. According to Pedcor, this loss of income translates into a 7.5% obsolescence figure. Pedcor argued that the fact that 44% of the rental units are set aside for lower-income tenants makes the other 56% of the rental units less desirable.

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- The State Board concluded that the deed restrictions “d[id] not fall within the definition of obsolescence” because they did not constitute “an external influence which affects the usage and operation of the property.” The State Board also pointed to the fact that Pedcor received a number of federal tax incentives as a result of the deed restrictions and argued that these tax incentives made up for any loss in rental income resulting from the deed restrictions.

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- The Tax Court found that:
  1) The federal tax incentives must be taken into account when evaluating whether the deed restrictions cause the apartment complex to experience economic obsolescence;
  2) The deed restrictions create financial benefits; and
  3) The vacancy of the apartment complex was not evidence of the complex suffering a loss of value.

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How to Value a Low Income Housing Property:

1. Per IC 6-1.1-4-41 (b), ***the true tax value of low income rental property is the greater of the true tax value:***

   (1) determined using the income capitalization approach; or

   (2) that results in a gross annual tax liability equal to five percent (5%) of the total gross rent received from the rental of all units in the property for the most recent taxpayer fiscal year that ends before the assessment date.

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- **Income Approach (2002 Real Property Manual – page 13):**

  The income approach to value is based on the assumption that potential buyers will pay no more for the subject property, hence they set the subject's value, than it would cost them to purchase an equally desirable substitute investment that offers the same return and risk as the subject property.

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It considers the subject property as an investment and, to that end; its value is based on the rent it will produce for the owner. It can be expressed in a formula as follows:

$I \div R = V$

Where: I = Income from rental of the property

R = Rate of return on the investment

V = Total Property Value

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- Like other income producing properties, the Income Approach for Low Income Housing is calculated using an estimated Net Operating Income (Gross Income less Operating Expenses) and converted to a present value by dividing it by a capitalization rate, which reflects the Discount Rate, the Recapture Rate, and the Effective Tax Rate.
- Replacement Reserves, which account for short-lived items, are considered an allowable operating expense.
- Tax credits may not be considered in determining the operating income of Low Income Housing Property.

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- **Recent IBTR and IN Tax Court Cases:**
- HOMETOWNE ASSOCIATES, L.P. d/b/a UNITY PARK v. JAMES P. MALEY, JR., TOWNSHIP ASSESSOR OF CENTER TOWNSHIP, MARION COUNTY, Cause No. 49T10-0208-TA-98 (12/16/2005)
- The sole issue involved an obsolescence adjustment for the 2001 assessment date.
- The Petitioner's Appraiser claimed:
  - Excess Operating Expenses (scattered-site nature of the project)
  - Location (high crime rate)

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- "Over-improvement" of the property
- Vandalism
- HUD Limitations (100% of the units had to be rented to low-income individuals)
- Damage Limitations
- It established a prima facie case that it was entitled to an obsolescence depreciation adjustment of at least 31.3%. The Assessor failed to rebut Unity Park's case; hence, the Tax Court ruled in favor of Unity Park.

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- BEDFORD APARTMENTS, An Indiana Limited Partnership, Petitioner v. TAMMIE HARRISON JEAN, in her official capacity as SHAWSWICK TOWNSHIP ASSESSOR, LAWRENCE COUNTY, Cause No. 49T10-0310-TA-51 (4/27/2006)
- The sole issue is whether the Indiana Board's final determination is erroneous because it failed to apply an economic obsolescence depreciation adjustment to Bedford's property for the March 1, 2001 assessment date

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- In the appraisal submitted, the Complex's rental restrictions were identified as the source of economic obsolescence. Obsolescence was quantified at 36%.
- The Indiana Board concluded that Bedford had not made a prima facie case for obsolescence. The Tax Court concurred.
- The Court has previously held that rental restrictions like the ones at issue in this case may very well cause economic obsolescence.

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- Nevertheless, when a taxpayer alleges that such rental restrictions are the cause of obsolescence, the taxpayer must show *how* the rental restrictions hinder the subject property's ability to generate income.
- In the context of §42 housing, that comparison has typically been made to unrestricted rents in the market place.

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- Nevertheless, the reason *why* the Complex charged lower rental rates was not because it was mandated to do so pursuant to the rental restrictions with the government; rather, as Bedford acknowledges, the reason it charged lower than market rates was because “the market would not support rents at the maximum allowable amounts. Therefore, rents had to be reduced.”
- This evidence clearly demonstrates that the *rent restrictions themselves* did not hinder the Complex’s ability to generate income.

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- Bedford did not link the alleged cause of the Complex’s obsolescence of which it complains with an actual loss in property value resulting from that cause. The IBTR’s final determination was affirmed.

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- LAFAYETTE HOUSING ASSOCIATES, L.P. and LAFAYETTE HOUSING ASSOCIATES II, L.P. v. NANCY MOORE, WEA TOWNSHIP ASSESSOR, TIPPECANOE COUNTY (Cause No. 49T 10-0206-TA-69) *Not for Publication (11/6/2006)
- Obsolescence depreciation denied by the IBTR.
- Petitioner contended:
  - Higher than Normal Vacancy Rates (15%)
  - High Operating Costs
  - Restricted Rents (unable to offset expenses)

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- Taxpayer charged lower than market rates so it could be competitive in the market.
- Taxpayer failed to establish a prima facie case.
- IBTR’s determination was affirmed.

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- Grandview Care, Inc. v. Perry County PTABOA (IBTR, 8/20/2008)
- Taxpayer filed for real and personal property tax exemption for 2006 and 2007 (80% exempt since 80% of units leased to qualifying tenants; 20% non-qualifying).
- Petitioner contended that Rev. Proc. 96-32 *Low Income Housing Guidelines* provides that if at least 75% of residents are earning at or below 80% of area median income, for federal tax purposes the property may be considered owned, occupied and used for charitable purpose.
- Prima facie case established; 80% exemption allowed.

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- South Bend Heritage Foundation, Inc. v. St. Joseph County PTBOA (IBTR, 9/11/2008)
- Taxpayer voluntarily restricted itself to renting to tenants that earned no more than 80% of the area's median income.
- Taxpayer also received funds from the Indiana Housing Finance Authority by agreeing to lease apartments at a reduced rent to people "transitioning back to society" (i.e. homeless).
- PTABOA conceded providing "low-income housing" qualifies as a charitable purpose.
- Taxpayer entitled to 100% exemption (IBTR noted its decision was a result of the PTABOA concession).

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- JAMESTOWN HOMES OF MISHAWAKA, INC. v. ST. JOSEPH COUNTY ASSESSOR Cause No. 49T1—0802-TA-17 (7/24/2009)
- Is housing, owned by a not-for-profit corporation who receives governmental subsidies so that it may rent to moderate/low-income individuals at below market rate, used for a charitable purpose?
- Apartments were financed and administered under the Section 221(d)(3) program – the maximum income for tenants was regulated and controlled.
- No evidence … that Jamestown has lessened the burden of government in meeting the need of affordable housing because that need is being met through its mortgage insurance and interest subsidy.

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- Shelby’s Landing-II, LP v. Shelby County Assessor (IBTR, 2/18/2010)
- Valuation issue for Shelby’s Crest Apartments and Shelby’s Landing Apartments.
- Petitioner’s appraiser only used the income approach. Also, petitioner contends that in Section 42 housing projects, cost is not equal to value due to the federal tax credits.
- The center of the dispute was the capitalization rate.
- The IBTR found in favor of the Petitioner “who overall presented a more convincing case.”

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- Housing Partnerships, Inc. v. Bartholomew County Assessor (IBTR, 4/6/2010)
- Taxpayer claimed property tax exemption.
- HPI was formed exclusively for charitable purposes with the primary objective of providing housing to disadvantaged individuals. It does not operate under any specific governmental program.
- HPI receives two types of grants – up front and reimbursement – that help with the costs of rehabbing properties.

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- Test for allowing the charitable use exemption from property tax has two parts:
  - There must be evidence of relief of human want manifested by obviously charitable acts different from the everyday purposes and activities of man in general; and
  - There must be an expectation that a benefit will inure to the general public sufficient to justify the loss of tax revenue.
- Like *Grandview Care v. Perry County,* exemptions for low income housing must be determined on an individual basis.
- Every exemption case depends on its facts and how those facts were presented. (Exemption denied)

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- Gulf Coast Housing Assistance Corporation v. Lake County Assessor (IBTR, 4/27/2010)
- Does the Petitioner's real and personal property qualify for tax exemption because the property is predominantly used for charitable purposes?
- Petitioner's counsel argued that to maintain its Section 501 (c)(3) status, it was required to rent at least 75% of its units to those earning at or below 80% of the Lake County average median income.
- Respondent's counsel argues, that in the *Jamestown* case, the Tax Court explicitly stated that while the provision of low-income housing relieves human want, the Court did not say that the provision of such housing rises to the level necessary for exemption.

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- The IBTR found that marketing a good or service to lower income individuals is an exempt purpose.
- The Petitioner's status as a 501 (c)(3) corporation is insufficient alone to qualify it for an exemption.
- "The grant of a federal or state income tax exemption does not entitle a taxpayer to a property tax exemption because an income tax exemption does not depend so much on how a property is used, but on how money is spent."
- **"As the law clearly states, it is the ownership, occupation and use of a property that determines its exempt purpose." (Emphasis added)**
- The Petitioner failed to raise a prima facie case.

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Questions?

Contact the Department

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